No. 95-928

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1995

JOHN W. ATHERTON, JR.,
*Petitioner,*

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,
As Receiver for CITY SAVINGS, F.S.B.,
*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Third Circuit**

## BRIEF OF AMICI CURIAE THE WASHINGTON LEGAL FOUNDATION AND ALLIED EDUCATIONAL FOUNDATION IN SUPPORT OF PETITIONER

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The Washington Legal Foundation and the Allied Educational Foundation, as amici curiae, respectfully submit this brief in support of Petitioner John W. Atherton, Jr., pursuant to Rule 37.3 of the Supreme Court Rules. By letters filed with the Clerk of the Court, the parties have consented to the filing of this brief for these amici.

## INTERESTS OF THE AMICI CURIAE

The Washington Legal Foundation (WLF) is a nonprofit public interest law and policy center based in Washington, D.C., which has supporters throughout the nation. WLF regularly appears before this Court and other federal and state courts promoting economic liberty, free enterprise principles, and the principle of limited and accountable government. WLF's Legal Studies Division also publishes monographs and other publications on these and related topics.

The issue presented in this case is of special concern to the pro-free enterprise mission of WLF. A sound free enterprise system requires well-managed financial institutions, which depends in turn on the ability to attract highly qualified persons as directors and officers of such institutions. The decision of the Third Circuit which is under review works against that objective: by creating confusion and uncertainty as to the applicable standard of care, and by attempting to impose broader liability exposure than Congress adopted or would exist under state law, the decision is almost certain to discourage service as director or officer of a federally-chartered thrift.

The court of appeals decision also offends the principle that the lawmaking powers of the federal judiciary should be circumscribed and subordinate. In effect, it substitutes the judgments of largely unaccountable federal judges — applying an undefined body of "federal common law" — in place of legislation enacted by Congress, as to the standards against which the actions of board members and management will be tested in suits arising from thrift insolvencies.



The Allied Educational Foundation (AEF) is a nonprofit charitable and educational foundation based in Englewood, New Jersey. Founded in 1964, AEF is dedicated to promoting education in diverse areas of study, including law and public policy. AEF has appeared before this Court as amicus curiae in numerous cases along with WLF.

## STATEMENT OF THE CASE

Petitioner is a former director and officer of a failed thrift, City Federal Savings Bank ("City Federal"). City Federal, a federally-chartered and federally-insured institution based in New Jersey, was declared insolvent and placed in receivership on December 7, 1989 by the Office of Thrift Supervision ("OTS"). That action was taken by OTS pursuant to its powers under the Home Owners' Loan Act of 1933, as amended by Section 301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, 103 Stat. 183 ("FIRREA").

Thereafter the Resolution Trust Corporation ("RTC" or "Receiver"), acting as receiver of a successor entity to which claims and assets of City Federal had been assigned, sued Petitioner and other former City Federal officials in the U.S. District Court for the District of New Jersey. It sought money damages on account of losses that had been incurred by City Federal in connection with defaulted real estate loans. The complaint asserted claims based on Petitioner's alleged negligence, gross negligence, and breach of fiduciary duty under "federal common law," as well as claims under New Jersey law that were later withdrawn in the district court.

The district court dismissed the complaint on November 15, 1993. (Appendix to Petition ("Pet.App.") at A57-A64). Its ruling was based on Section 212(a) of FIRREA, codified in pertinent part at 12 U.S.C. § 1821(k)(1989), which provides as follows:

> (k) LIABILITY OF DIRECTORS AND OFFICERS. — A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by...[the RTC]...acting as conservator or receiver of such institution...for gross negligence, including any similar conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law. Nothing in this paragraph shall impair or affect any right of the [RTC] under other applicable law.

The district court concluded that Section 1821(k) established an exclusive, uniform federal standard of care of gross negligence for purposes of damages actions by the RTC against former directors and officers of federally chartered thrifts in receivership, and that this new statutory standard preempted any federal common law claims. (Pet. App. A63-A64).

On interlocutory appeal pursuant to 28 U.S.C. § 1292(b), the U.S. Court of Appeals for the Third Circuit reversed the district court, in a decision authored by Circuit Judge Becker and issued June 23, 1995. *Resolution Trust Corporation v. CityFed Financial Corporation*, 57 F.3d 1231 (3d Cir. 1995) (Pet.App. A1-A37). It held that the Receiver must be permitted to proceed against City



Federal's former directors and officers on claims for negligence and breach of fiduciary duty under federal common law, and that such claims are not displaced by 12 U.S.C. § 1821(k). 57 F.3d at 1249. Amazingly, the court went on to rule that the federal gross negligence standard of Section 1821(k) is applicable only to state-chartered thrifts and does not apply at all to federally-chartered institutions — notwithstanding that they are federally-insured and within the express coverage of the statute — so the Receiver has no cause of action against former City Federal directors and officers under that statutory provision.[1] *Id.*, n.17. One member of the merits panel dissented, concluding that Section 1821(k) does apply in cases involving federally-chartered insured depository institutions, that it establishes a uniform gross negligence standard, and that it supplants federal common law. *Id.* at 1249-55 (Mansmann, J., dissenting). (Pet.App. A38-A50). Requests by Petitioner and the other defendants for rehearing and rehearing *en banc* were denied by the court of appeals on September 14, 1995. (Pet.App. A54-A56).

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[1] This part of the Third Circuit decision leads to a seemingly bizarre result: in the event there is no applicable federal common law, actions against former officials of federally-chartered thrifts in receivership would have to be based on state law, which may be more lenient than the federal gross negligence standard of § 1821(k) that applies to all state-chartered institutions. Even the Respondent concedes that the court of appeals was wrong in holding that § 1821(k) applies only to state-chartered institutions, but it has not sought review of that ruling.

Petitioner filed a timely petition for certiorari.[2] This Court granted the writ on April 15, 1996 in order to review the decision of the Third Circuit. 116 S.Ct. 1415 (1996).

## SUMMARY OF ARGUMENT

This case is controlled by the decision in *O'Melveny & Myers v. FDIC*, 114 S. Ct. 2048 (1994). The Third Circuit, ignoring *O'Melveny*, erroneously assumed the existence of federal common law rules of decision to govern the liabilities of directors and officers of federally-insured thrifts. The court never examined the validity of that assumption, and never identified any source of judicial authority to create such rules.

What *O'Melveny* said, and the Third Circuit should have followed, was that suits for monetary damages asserted by the receiver of a failed federally-insured association do *not* implicate such federal interests as to warrant the invention or application of federal common law. The fact that the association once held a federal charter does not appear to be a material distinction for purposes of the required analysis. Moreover, enactment of FIRREA "demolished" any argument by the FDIC to apply federal common law in this case. That is because FIRREA contains numerous provisions which create special federal rules of decision regarding claims by the receiver, including Section 1821(k) which sets out specific standards for imposing liability against former directors and officers.

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[2] Following the filing of the certiorari petition, the RTC was succeeded in its receivership capacity by the Federal Deposit Insurance Corporation ("FDIC"), which now appears as Respondent before this Court.



Since Congress has considered and adopted legislation on this matter, the courts have no authority to make different rules.

The Third Circuit improperly ignored the strong presumption that state law should be applied by federal courts whenever possible, as reflected in the Rules of Decision Act and numerous decisions of this Court. Relevant considerations for determining whether federal common law should be created in aid of a federal statute or program, as described by this Court in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), and *O'Melveny* were not taken into account by the court of appeals, which essentially performed no analysis at all.

Finally, the court of appeals was incorrect in suggesting that *Briggs v. Spaulding*, 141 U.S. 132 (1891), somehow justifies or requires that the liabilities of directors and officers of federally-chartered institutions be determined under federal common law standards. That case says nothing of the kind, and there is no need for this Court to reexamine the common law liability rules discussed in the century-old *Briggs* opinion.

## ARGUMENT

The Third Circuit, in addressing the interlocutory appeal from the dismissal of the Receiver's claim, essentially framed the issue as whether the gross negligence standard of 12 U.S.C. § 1821(k) displaces or supplants federal common law standards that may impose liability against directors and officers of insolvent federally-insured depository institutions "for conduct less culpable than gross negligence (*e.g.* for ordinary negligence)." 57 F.3d at 1234 (Pet.App. A7). Formulating the case in that manner

implicitly made a significant, highly dubious assumption which appears to have misdirected the Third Circuit's inquiry. Logically, and as a matter of coherent analysis, the questions that need to be addressed are more aptly approached in a two-step sequence:

> (1) Is there any federal common law that establishes a standard of care for directors and officers of insured financial institutions?
>
> (2) If so, does such federal common law standard of care survive the enactment of Section 1821(k)?

Amici respectfully submit that the answer to the first inquiry is so plainly negative that the second question, concerning the effect of the FIRREA provision, never needs to be reached at all.[3]

## I. THERE IS NO FEDERAL COMMON LAW STANDARD OF CARE FOR DIRECTORS AND OFFICERS OF FEDERALLY-INSURED AND FEDERALLY-CHARTERED THRIFTS.

The Third Circuit started its legal analysis with a prominent citation to this Court's decision in *O'Melveny & Myers v. FDIC*, 114 S.Ct. 2048 (1994). Regrettably, what should have been a starring role for *O'Melveny* proved to

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[3] The issues of whether and to what extent § 1821(k) preempts state law and creates the exclusive standard of care for federally-insured thrift directors and officers in receivership suits are not presented in this case, as the Receiver abandoned its state law claims before the district court.



be only a brief cameo appearance. Either the appellate panel never actually read that key decision, decided to ignore it, or simply failed to grasp *O'Melveny's* clear and controlling import — "***There is no federal general common law***," and no basis for creating special federal judge-made rules of decision simply to enhance recoveries in failed thrift receivership litigation. *Id.* at 2053, quoting *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938) (emphasis added).[4] The court of appeals got off on the wrong foot by trying to ascertain whether FIRREA displaced or supplanted federal common law, *see* 57 F.3d at 1244-49 (Pet.App. A27-A36), rather than determining whether there ever was any basis for creating federal common law in the first place.

### a. The Decision of the Court of Appeals Violates the Unmistakable Teaching of *O'Melveny*.

The Third Circuit did not attempt to distinguish *O'Melveny & Myers v. FDIC* from this case, and there does not appear to be any material distinction that would produce a different outcome. By unaccountably ignoring that decision, the Third Circuit failed to apply the law as clearly announced by the Supreme Court just one year earlier.

As here, the FDIC, appearing in *O'Melveny* as receiver of an insolvent state-chartered savings and loan association, asserted the applicability of federal common law in suits to

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[4] *Accord, Petro-Tech, Inc. v. Western Co. of North America*, 824 F.2d 1349 (3d Cir. 1987) (acknowledging in civil RICO case that "there is no federal general common law," citing *Erie*)(Becker, J.).

recover losses suffered by the thrift in connection with real estate transactions. One target of that litigation was a deep-pockets law firm that the FDIC alleged was negligent and breached its fiduciary duty in performing services for the association. Although its cause of action arose under state law, the FDIC argued that certain knowledge-imputation defenses raised by the law firm had to be determined under federal common law. With respect to claims of the savings and loan against the defendant firm, the FDIC argument was swiftly rejected by this Court as "so plainly wrong" that it needed little discussion beyond quoting *Erie*. 114 S. Ct. at 2052.

The Receiver's position in this case is materially the same, and equally wrong. The Receiver claims only to stand in the shoes of City Federal with respect to the institution's "preexisting" common law cause of action against Petitioner — and not to assert any special or unique powers that, upon its appointment as Receiver, automatically converted its suit to a federal statutory cause of action — but it argues that the source of that cause of action must be ***federal*** law simply because City Federal operated under a charter issued by the federal government. (*See* Brief for the Respondent in Opposition, pp. I, 8-9). Amici believe that argument is foreclosed by the *O'Melveny* decision. The Receiver is on no sounder footing in invoking federal rules of decision here, by virtue of the closed institution's federal charter, than where it sought help from federal common law in asserting state law claims of an insolvent state-chartered, federally-insured institution.

*O'Melveny* further considered whether the FDIC's status as a receiver under pre-FIRREA federal statutory authority somehow authorized the creation of special



federal rules of decision in the actions it brought. The Court, holding that this was ***not*** one of those "few and restricted" cases where "judicial creation of a special federal rule would be justified," rejected the argument that state law should be displaced because of the receivership. *Id*. at 2055. As the opinion explained:

> What is fatal to Respondent's position in the present case is that it has identified *no* significant conflict with an identifiable federal policy or interest. There is not even at stake that most generic (and lightly invoked) of alleged federal interests, the interest in uniformity. The rules of decision at issue here do not govern the primary conduct of the United States or any of its agents or contractors, but affect only the FDIC's rights and liabilities, as receiver, with respect to primary conduct on the part of private actors that has already occurred.

*Id*. at 2055. Likewise the FDIC's obvious interest in more favorable rules of decision in order to enhance its prospects of winning in receivership litigation was rejected as insufficient. *Id*.

Even more significant in *O'Melveny* is this Court's assessment of the effect of FIRREA, which was enacted after commencement of that receivership. The FDIC argued there that the new statute justified creation of federal common law, "as a *nonexclusive* grant of rights to the FDIC receiver, which can be supplemented or modified by federal common law; and that FIRREA as a whole, by demonstrating the high federal interest in this area, confirms the courts' authority to promulgate such common law." *Id*. at 2054. But, the Court held, "This argument is

demolished by those provisions of FIRREA [including Section 1821(k)] which specifically create special federal rules of decision regarding claims by, and defenses against, the FDIC as receiver." *Id.* The undeniable message for the present case is that Section 1821(k), expressly authorizing claims against directors and officers for gross negligence, excludes any possibility that the FDIC may pursue claims against such parties under some other federal common law standard of care.

**b. The Assumption That Federal Common Law Exists and Applies In This Case Is Contrary to the Rules of Decision Act and Decisions of This Court.**

The Rules of Decision Act, codified at 28 U.S.C. § 1652 and based on Section 34 of the Judiciary Act of 1789, 1 Stat. 92, states that:

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

The statute creates a presumption that state law — not federal common law — is to be applied by federal courts in ***all*** civil litigation (not just diversity cases) except to the extent that a federal statute, treaty or Constitutional provision authorizes or requires a different rule of decision. The question thus is whether a federal statute such as FIRREA mandates or authorizes judicial creation of additional or interstitial federal common law rules to be applied in D&O litigation involving failed thrifts. If not,



negligence standard of Section 1821(k) or the standards of care established under state common law, to the extent not preempted — and the matter of *which* of those applies is not presented here.

This Court has identified the considerations relevant to determining whether federal common law should be created in aid of a federal statute or program, or whether state law should be utilized.[5] These include: (1) the need for nationwide uniformity in a federal program; (2) whether specific objectives of the federal program would be frustrated by application of state law; and (3) the potential disruption of commercial relations predicated on state law if different federal rules are created. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728-29 (1979). Furthermore, a court-made federal rule should not be adopted "to supplement federal statutory regulation that is comprehensive and detailed; matters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law." *O'Melveny*, 114 S. Ct. at 2054.

Unfortunately, the Third Circuit neglected even to consider these factors, much less weigh them, in its blithe assumption that federal common law would supply the rule of decision for the Receiver's action against Petitioner. Nothing in this case supports a compelling need to apply uniform federal common law standards in damages actions against former officials of insolvent federally-insured thrifts

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[5] Even where interstitial rules must be developed by the courts as part of a federal statutory scheme, which comprise a form of federal common law, there is a presumption in favor of adopting state law for that purpose. *See, e.g., Wilson v. Garcia*, 471 U.S. 261 (1985).

against former officials of insolvent federally-insured thrifts — some of which are chartered by the states and some of which have federal charters. Further, as indicated in *O'Melveny*, the comprehensive scope of FIRREA and its inclusion of a gross negligence standard in Section 1821(k) militates strongly against creation or enforcement of federal judge-made standards of conduct in this field.

### c. This Court's Decision In *Briggs v. Spaulding* a Century Ago Is Not Precedent For Imposing Federal Common Law Standards of Care.

The suggestion by the Third Circuit in footnote 16 of its opinion, 57 F.3d at 1247 (Pet.App. A32-A33), that a federal common law standard of care for directors and officers of federally-chartered depository institutions has existed since *Briggs v. Spaulding*, 141 U.S. 132 (1891), is incorrect and misleading. Although *Briggs* involved the receivership of a national bank, nothing in that decision indicated that the applicable standard was a matter of *federal* common law, as distinct from general law or state law. And the more recent, post-*Erie* Supreme Court decision in *Wichita Royalty Co. v. City National Bank*, 306 U.S. 103, 107 (1939), holds that, in litigation involving claims by or against an insolvent national bank, a federal court is obligated to follow the applicable rulings of state courts and is not free to make up a federal rule of decision.

Moreover, since federal judges are not generally authorized to establish the rules of decision for such cases, there is no occasion for this Court to accept the court of appeals' invitation in note 16 "to reexamine and/or refine the *Briggs* articulation of the common law standard of liability for directors and officers of [federally-chartered] institutions." This gratuitous suggestion illustrates the



federal court discretion to change the rules by which business is conducted, whenever deemed appropriate and despite the recent enactment of comprehensive legislation covering the same matters. It is another demonstration of "the runaway tendencies of 'federal common law' untethered to a genuinely identifiable (as opposed to judicially constructed) federal policy." *O'Melveny & Myers v. FDIC*, 114 S. Ct. at 2055. If anyone is to undertake such a redefinition, involving far-reaching policy questions, it should be Congress rather than the federal judiciary. *Id.*, 76-77; *Texas Industries, Inc. v. Radcliffe Materials, Inc.*, 451 U.S. 630, 646-47 (1981).

## CONCLUSION

The decision of the Third Circuit should be reversed, and this Court should clarify that directors and officers of federally-insured depository institutions are not subject to claims based on "federal common law" standards of conduct.

Respectfully submitted,

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